Report

of the

Examination of

River Falls Mutual Insurance Company

River Falls, Wisconsin

As of December 31, 2004

TABLE OF CONTENTS

Page

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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October 7, 2005

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2004, of the affairs and financial condition of:

RIVER FALLS MUTUAL INSURANCE COMPANY
River Falls, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of River Falls Mutual Insurance Company (the company) was made in 2000 as of December 31, 1999. The current examination covered the intervening time period ending December 31, 2004, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on July 1, 1876, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the River Falls Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were no amendments to the articles of incorporation or to the bylaws. The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties: Dunn, Pepin, Pierce, and St. Croix.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis. The company also charges a policy fee of $20 for each policy and $3 for each installment.

Business of the company is acquired through one agent who is a director of the company. Agents are presently compensated for their services as follows:

Type of Policy	Compensation
New Business and Endorsements	15%
Renewal Business	0

Agents have authority to adjust losses up to $5,000. Losses in excess of this amount are adjusted by the company's adjuster. Adjusters receive $65 per hour for each loss adjusted.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Richard Ruemmele	Senior Loan Officer	Prescott, WI	2008
Gerald Williams	Dairy Farmer	River Falls, WI	2008
Jeffrey Dusek *	Company Manager	River Falls, WI	2006
Louis Barber	Retired County Conservationist	Beldenville, WI	2007
Steven Brand	Dairy Farmer	Ellsworth, WI	2007
Donald Dusek	Assistant Company Manager	River Falls, WI	2007
Thomas Sitz	Loan Officer	River Falls, WI	2006

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $125 for each day meeting attended, $100 for each evening meeting attended and $.405 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2004 Compensation
Richard Ruemmele	President	$ 1,200
Gerald Williams	Vice President	150
Jeffrey Dusek	Secretary/Treasurer/Manager	59,076

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee	Investment Committee	Executive Committee
Steven Brand	Tom Sitz	Richard Rummele
Richard Rummele	Louis Barber	Gerald Williams
Gerald Williams	Donald Dusek	Jeffrey Dusek
Jeffrey Dusek	Jeffrey Dusek	

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income (Loss)	Admitted Assets	Policyholders' Surplus
2004	$531,820	913	$ 183,885	$1,980,400	$1,422,387
2003	482,988	927	181,919	1,602,323	1,060,512
2002	423,103	902	57,504	1,573,283	910,662
2001	359,132	910	(180,039)	1,654,630	954,941
2000	402,602	893	(82,803)	1,780,812	1,176,132
1999	312,797	889	(18,758)	1,700,148	1,196,545

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios	
				Net	Gross
2004	$1,120,346	$520,569	$1,422,387	37%	45%
2003	1,097,775	520,436	1,060,512	49	15
2002	985,190	461,864	910,662	51	61
2001	872,217	380,549	954,941	40	391
2000	803,034	338,361	1,176,132	29	83
1999	756,295	388,863	1,196,545	32	44

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Com-posite Ratio
2004	$236,247	$152,078	$531,820	44%	29%	74%
2003	192,058	153,399	482,988	40	29	69
2002	258,533	145,298	423,103	61	31	93
2001	414,347	143,015	359,132	115	38	153
2000	407,160	126,786	402,602	101	37	139
1999	231,788	140,483	312,797	74	36	110

Surplus has increased by 18.9% from $1,196,545 in 1999 to $1,422,387 in 2004. Most of this increase was realized in the last three years when the company experienced a positive net income. The company had experienced high net losses in 2000 and 2001 as a result of severe storm-related damage throughout their territory. The company’s net loss ratios were 101% and 115% in 2000 and 2001, respectively. However, from 2002 to 2004 storm-related damages diminished and the company's loss ratio was at a more reasonable level, ranging from 40% to 61%. Additionally, the company has made efforts to improve underwriting results by inspecting all new policies and re-inspecting selected policy renewals.

Admitted assets show a similar trend with a 16.5% increase over the examination period and a 25.9% increase over the last three years. Gross premium written and net premium written increased over the five-year period by 48.1% and 33.9%, respectively. Meanwhile, policies in force have only increased 2.7% since the last exam. This is primarily due to the company writing higher premium policies on farms and promoting new programs.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2005
Termination provisions:	As of any January 1 by either party giving 90 days' prior written notice

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Casualty Excess of Loss
	Lines reinsured:	All liability (nonproperty) business
	Company's retention:	$2,500 for each and every loss occurrence. The reinsurer may permit the company to adjust property damage losses that fall within the company's net loss retention.
	Coverage:	Loss and loss adjustment expense in excess of the company's retention up to the following maximum policy limits: $1,000,000 – per occurrence, single limit, combined for bodily injury and property damage liability. $1,000,000 – split limits, in any combination of bodily injury and property damage liability. $5,000 – for medical payments, per person; $25,000 per accident.
	Reinsurance premium:	60% of the premium written for each and every policy of the business covered.
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	When the company's net retention is $350,000 or more, the company may cede on a pro rata basis up to $800,000. When the net retention is $350,000 or less, the company may cede up to 50% of such risk. Notwithstanding any other provision of this Class B First Surplus Reinsurance, the company shall retain an Annual Aggregate Deductible equal to 10% of the loss and loss adjusting expenses otherwise recoverable hereunder.

Coverage: Pro rata share of each and every loss, including loss adjustment expense, corresponding to the amount of the risk ceded.

Reinsurance premium: Pro rata of all premiums, fees and assessments corresponding to each of the risk ceded.

Ceding commission: Commission allowance: 15% of subject premium paid
Profit commission: 15% of subject net profit

3. Type of contract: Class C-1 First Layer Excess of Loss

Lines reinsured: All property business written by the company

Company's retention: $40,000 for each and every risk resulting from one loss occurrence.

Coverage: 100% of any loss, including loss adjustment expenses, in excess of $40,000 up to a maximum of $60,000 in respect to each and every loss occurrence.

Reinsurance premium: The rate in effect shall be determined by taking the sum of the four years' losses incurred (paid plus outstanding) by the reinsurer divided by the total of the net premiums written for the same period, multiplied by the factor 100/80ths, subject to a maximum rate of 21.75% and a minimum rate of 6%.

The current effective rate is 11.49%.
The current annual deposit premium is $83,647, subject to a minimum premium of $65,000.

4. Type of contract: Class C-2 Second Layer Excess of Loss

Lines reinsured: All property business written by the company

Company's retention: $100,000 for each and every loss occurrence.

Coverage: 100% of any loss, including loss adjustment expenses, in excess of $100,000 for each and every risk resulting from one loss occurrence up to a maximum of $250,000 in respect to each and every loss occurrence.

Reinsurance premium: 3.25% of the current subject net premiums written
Annual deposit premium: $23,660
Annual minimum premium: $18,000

5. Type of contract: Class D/E – 1 First Layer Aggregate Stop Loss

Lines reinsured: All property and nonproperty business written by the company

Company's retention: Part A – Catastrophe: $75,000 of net losses, excluding loss adjustment expenses, arising out of each loss occurrence.

	Part B – Stop Loss: 75% of net premiums written, subject to a minimum retention of $400,000. The minimum retention does not apply in the event of the company's rehabilitation, liquidation, or dissolution.
Coverage:	Part A – Catastrophe: 100% of net losses in excess of the company's retention, excluding loss adjustment expenses, up to $250,000 per occurrence and $500,000 in aggregate. Part B – 100% of net losses, including loss adjustment expenses, of annual aggregate losses exceeding 75% of net premium written and in excess of the company's retention.
Reinsurance premium:	The rate for each annual period shall be determined by taking the sum of the eight years' losses incurred by the reinsurer divided by the total of the net premiums written for the same period multiplied by the factor of 100/80ths, subject to a maximum rate of 25% and a minimum rate of 8.5%. Current rate: 15.0% Annual deposit premium: $120,900 Annual minimum premium: $95,000

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

River Falls Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2004

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in company's office	$ 100	$	$	$ 100
Cash deposited in checking account	45,841			45,841
Cash deposited at interest	712,271			712,271
Bonds	304,616			304,616
Stocks and mutual fund investments	644,637			644,637
Premiums, agents' balances and installments:				
In course of collection	19,189			19,189
Deferred and not yet due	139,204			139,204
Investment income accrued		3,414		3,414
Reinsurance recoverable on paid losses and lae	99,520			99,520
Electronic data processing equipment	8,045			8,045
Other expense-related assets:				
Reinsurance commission receivable	3,291			3,291
Other nonexpense-related assets:				
Federal income tax recoverable	272			272
Furniture and fixtures	3,517		3,517	
Totals	$1,980,503	$3,414	$3,517	$1,980,400

Liabilities and Surplus
As of December 31, 2004

Net unpaid losses	$ 75,952
Unpaid loss adjustment expenses	5,359
Fire department dues payable	351
Unearned premiums	425,291
Reinsurance payable	9,882
Payroll taxes payable (employer’s portion)	25
Other liabilities:	
Expense-related:	
Accounts payable	2,565
Nonexpense-related:	
Premiums received in advance	38,588
Total Liabilities	558,013
Policyholders' surplus	1,422,387
Total Liabilities and Surplus	$1,980,400

River Falls Mutual Insurance Company
Statement of Operations
For the Year 2004

Net premiums and assessments earned		$531,820
Deduct:		
Net losses incurred	$193,070	
Net loss adjustment expenses incurred	43,177	
Other underwriting expenses incurred	152,078	
Total losses and expenses incurred		388,325
Net underwriting gain (loss)		143,495
Net investment income:		
Net investment income earned	21,871	
Net realized capital gains	(121)	
Total investment gain (loss)		21,750
Other income (expense):		
Policy fees	21,575	
Miscellaneous income	1,693	
Total other income		23,268
Net income before federal income taxes		188,513
Federal income taxes incurred		4,628
Net Income		$183,885

River Falls Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2004

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2004	2003	2002	2001	2000
Surplus, beginning of year	$1,060,512	$ 910,662	$954,942	$1,176,132	$1,196,545
Net income	183,885	181,919	57,504	(180,038)	(82,803)
Net unrealized capital gains or (losses)	181,537	(31,504)	(112,796)	(29,457)	63,775
Change in nonadmitted assets	(3,547)	(565)	11,012	(11,695)	(1,385)
Surplus, end of year	$1,422,387	$1,060,512	$910,662	$ 954,942	$1,176,132

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2004, is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company hire an attorney to prepare a new Agency Agreement which more accurately reflects the true nature of the relationship. The draft of the new agreement should be submitted to OCI for approval prior to submission to the Board for approval.

   Action—Compliance.

2. Corporate Records—It is recommended that the company execute formal written agreements with its agents.

   Action—Compliance.

3. Corporate Records—It is recommended that the company file amended articles and bylaws with this office as soon as possible after any changes have been voted on and approved in accordance with s. 612.04 (2), Wis. Stat.

   Action—Compliance.

4. Underwriting—It is recommended that the company take action to ensure that all ceding slips are updated to reflect any policy changes.

   Action—Compliance.

5. Accounts and Records—It is recommended that the company retain original accounting records for a period of three years in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code.

   Action—Compliance.

6. Stocks and Mutual Funds—It is recommended that River Falls Mutual Insurance Company submit a request to OCI to allow the company to invest a larger percent of its admitted assets (i.e., 30% or 35%) in preferred and common stocks.

   Action—Compliance.

7. Stocks and Mutual Funds—It is recommended that the company divest of the GAM International mutual fund within 3 years if the mutual fund's rating does not increase to a 4- or 5-star Morningstar rating. If the mutual fund's rating does increase to 4 or 5 stars, the company should keep documentation showing the increased rating and the date in accordance with s. Ins 6.20 (d) (3) (c), Wis. Adm. Code.

   Action—Compliance.

8. Net Unpaid Losses—It is recommended that, in future years, the company increase its Liability IBNR Reserves to more reasonably reflect Liability IBNR development.

   Action—Compliance.

9. Claim Payments—It is recommended that the company ensure that all proof of loss statements be signed by the claimant. In addition, it is recommended that the company date-stamp documentation supporting losses claimed as evidence that the company is responding to claims in a timely manner.

   Action—Partial Compliance.

10. Unearned Premiums—It is recommended that the company properly report unearned premiums in the future.

    Action—Compliance.

11. Unearned Premiums—It is suggested that, in the future, advance paid premiums be reported separately from unearned premiums on the preprinted Annual Statement line.

    Action—Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed a formal written agreement with its only agency, which is owned by the company's secretary-treasurer and manager. The agreement governs the company's relationship to the secretary-treasurer as an officer of the company and as the owner of an agency. Among other provisions, in the event that the business of the agency were offered for sale, the agreement provides the company with the first option to buy the business with a purchase price of 1.5 times the previous annual policy commissions received by the agency. It is not an agency contract in that the agreement does not formally appoint the agency and does not describe the company's commitments to the agency or the agency's commitments to the company. The agreement appeared sufficient to address the current circumstances of the company. If the company were to appoint other agents, an agent contract would need to be developed for all of the company's agents.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 250,000
Worker’s compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	500,000
Each employee	500,000
Policy limit	1,000,000
Combined professional and D&O liability	2,000,000
Commercial personal property	36,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained.
2. A proper cash receipts journal is maintained.
3. A proper cash disbursements journal is maintained.
4. A proper general journal is maintained.

5. A proper general ledger is maintained.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2004.

The company is audited annually by an independent public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computers is limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept on-site. A monthly backed-up disk and annual back-up are also stored off-site. Given the company's size and the frequency of the posting of transactions, it would be a sound risk management measure for the company to increase the frequency of its off-site back-up of its computerized data. The loss or destruction of the hard copies and electronic copies of company records could coincide with a larger disaster affecting many of its policyholders. In that event, the back-up procedures could allow the company to focus on claims as opposed to the restoration of records. It is recommended that the company back up its computerized data for storage off-site on a weekly basis.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$ 858,013
2.	Liabilities plus 33% of gross premiums written	927,727
3.	Liabilities plus 50% of net premiums written	818,298
4.	Amount required (greater of 1, 2, or 3)	927,727
5.	Amount of Type 1 investments as of 12/31/2004	1,237,348
6.	Excess or (deficiency)	$ 309,621

The company has sufficient Type 1 investments.

The company has OCI approval to exceed the normal individual investment limitation in WRC common stock as long as the company does not exceed 30% of admitted assets of investments in common stock, preferred stock and mutual funds.

ASSETS

Cash and Invested Cash **$758,212**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 100
Cash deposited in banks checking accounts	45,841
Cash deposited in banks at interest	712,271
Total	$758,212

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained at a local bank. Verification of the checking account balance was made by obtaining confirmation directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 18 deposits in 9 depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2004 totaled $20,227 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 0.40% to 3.36%. Accrued interest on cash deposits totaled $1,296 at year-end.

Book Value of Bonds **$304,616**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2004. Bonds owned by the company are held by a bank under a custodial agreement.

Bonds were traced to the custodial statement for the year ended December 31, 2004. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2004 on bonds amounted to $13,772 and was traced to cash receipts records. Accrued interest of $2,118 at December 31, 2004, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$644,637**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2004. Stocks owned by the company are held by a bank under a custodial agreement.

Stock and mutual fund holdings were verified either by being traced to the custodial statement for the year ended December 31, 2004, or through physical inspection of certificates evidencing the company's ownership. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2004 on stocks and mutual funds amounted to $10,875 and were traced to cash receipts records.

Premiums, Agents' Balances in Course of Collection **$19,189**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

Premiums Deferred and Not Yet Due **$139,204**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company's detailed list of deferred premiums verified the accuracy of this asset. During review of this sample, the examiner noted paid installments for policies with effective dates prior to year-end were included in the deferred premium balance. The examiner reviewed the total year-end balance, which resulted in an overstatement of $6,407. An adjustment was not deemed necessary for purposes of this examination due to a lack of materiality. However, a recommendation is made in the "Advance Premium" section of this report.

Investment Income Accrued **$3,414**

Interest due and accrued on the various assets of the company at December 31, 2004, consists of the following:

Cash at Interest	$1,296
Bonds	2,118
Total	$3,414

Reinsurance Recoverable on Paid Losses and LAE **$99,520**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2004. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$8,045**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2004. A review of receipts and other documentation verified the balance. Non-operating system software was properly nonadmitted. During review of the company's EDP equipment depreciation calculation, the examiners noted that EDP equipment is being depreciated on a 5-year basis. Pursuant to SSAP No. 16, EDP equipment shall be depreciated over 3 years or the useful life, whichever is shorter. It is recommended that the company properly calculate depreciation on EDP equipment in accordance with SSAP No. 16. During review of the company's EDP equipment balance, the examiners noted that leasehold improvements are being depreciated on a 15-year basis. Pursuant to SSAP No. 19, leasehold improvements shall be depreciated over the term of the lease or the useful life, whichever is shorter. It is recommended that the company properly calculate depreciation on leasehold improvements in accordance with SSAP No. 19 and report leasehold improvements as a separate line item.

Reinsurance Commission Receivable **$3,291**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2004, under the contract with its reinsurer. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

Federal Income Tax Recoverable **$272**

The above asset represents the amount of a federal income tax refund that the company expected to receive as of December 31, 2004. The company's federal income tax return for 2004 completed by a certified public accountant verified the above asset.

Furniture and Fixtures **$0**

This asset consists of $2,928 of furniture and fixtures owned by the company at December 31, 2004. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

Software **$0**

This asset consists of $589 of software owned by the company at December 31, 2004. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$75,952**

This liability represents losses incurred on or prior to December 31, 2004, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2004, with incurred dates in 2004 and prior years. To the actual paid loss figure was added an estimated amount for 2004 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$130,767	$122,208	$ 8,560
Less: Reinsurance recoverable on unpaid losses	54,815	58,076	(3,261)
Net Unpaid Losses	$ 75,952	$ 64,132	$11,821

The net difference in Net Unpaid Losses is not material thus no adjustment was made to policyholders' surplus.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were not properly signed.

During review of claim files, the examiner noted not all proof of loss statements over the company's $500 threshold were signed, dated and stamped. It is again recommended that the company ensure that all proof of loss statements be signed by the claimant. In addition, it is again recommended that the company date-stamp documentation supporting losses claimed as evidence that the company is responding to claims in a timely manner.

Unpaid Loss Adjustment Expenses **$5,359**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2004, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is by adding the year-end unpaid loss adjustment expenses to 20% of year-end IBNR.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated. Using a three-year weighted average, the examiners determined an appropriate accrual for this liability would be $6,683. The $1,324 difference between the amount calculated by the examiners and the annual statement amount was not considered material for purposes of this examination. Therefore, no adjustment to policyholders' surplus was made due to lack of materiality.

Fire Department Dues Payable **$351**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2004.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$425,291**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. During testing of this balance, the examiners noted paid installments for policies with effective dates prior to year-end were included in the deferred premium and advanced premium balances, but not in the unearned premium. This resulted in an understatement of unearned premium of $6,407, which was offset by an equal overstatement of the Premiums Received in Advance account. An adjustment was not deemed necessary for purposes of this examination due to a lack of materiality. However, a recommendation is made in the "Advance Premium" section of this report.

Reinsurance Payable **$9,882**

This liability consists of amounts due to the company's reinsurer at December 31, 2004, relating to transactions which occurred on or prior to that date. These amounts consist of the estimated payable amount at year-end based upon the reinsurer's adjusted calculations. Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Payroll Taxes Payable **$25**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2004, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$2,565**

This liability represents the balance payable at year-end for accounts payable and other accrued expenses incurred prior to December 31, 2004. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$38,588**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2004. The examiners reviewed 2004 premium and cash receipt records to verify the adequacy of this liability. During testing of this balance, the examiners noted paid installments for policies with effective dates prior to year-end were included in the advanced premium balance. This resulted in an overstatement of $6,407 in advance premium. It is recommended that the company adjust for installment payments for policies with effective dates prior to year-end which are reported as advance premium. An adjustment was not deemed necessary for purposes of this examination due to a lack of materiality.

V. CONCLUSION

The company reported assets of $1,980,400, liabilities of $558,013 and policyholders' surplus of $1,422,387 at year-end 2004. The assets and policyholders' surplus are at all-time highs for the company. Gross premium written and net premium written increased 48.1% and 33.9% to $1,120, 346 and $520,569, respectively, over the previous five-year period. The company has had a positive net income in each of the last three years.

There were four recommendations as a result of this examination, one of which was repeated from the previous examination. Recommendations pertained mainly to record keeping and reporting requirements of the company.

There were no adjustments to policyholders' surplus as a result of the examination.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 22 - EDP Equipment—It is recommended that the company properly calculate depreciation on EDP equipment in accordance with SSAP No. 16.

2. Page 22 - EDP Equipment—It is recommended that the company properly calculate depreciation on leasehold improvements in accordance with SSAP No. 19 and report leasehold improvements as a separate line item.

3. Page 24 - Net Unpaid Losses—It is again recommended that the company ensure that all proof of loss statements be signed by the claimant. In addition, it is again recommended that the company date-stamp documentation supporting losses claimed as evidence that the company is responding to claims in a timely manner.

4. Page 26 - Premiums Received in Advance—It is recommended that the company adjust for installment payments for policies with effective dates prior to year-end which are reported as advance premium.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Jean Suchomel of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Karl Albert
Examiner-in-Charge